UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Communications and Information
Washington, D.C. 20230

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FEDERAL COMMUNICATIONS COMMISSION
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The Honorable Reed E. Hundt
Chairman
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: Rules and Policies for Local Multipoint Distribution Service, First Report and Order and Fourth Notice of Proposed Rulemaking, CC Docket No. 92-297

Dear Chairman Hundt:

I am writing as the head of the National Telecommunications and Information Administration (NTIA), which is the principal advisor to the Executive Branch on telecommunications and information policy issues. As such, I would like to address one very important issue raised in the Commission's Fourth Notice of Proposed Rulemaking (Notice) in the above-referenced proceeding. In the Notice, the Commission requests comment on whether incumbent Local Exchange Companies (LECs) and cable television operators (referred to collectively as "incumbents") should be eligible to bid at auction for a Local Multipoint Distribution Service (LMDS) license. Although LMDS was viewed initially as merely an alternative multichannel video programming service, it has become clear that LMDS licensees will also be able to offer local exchange telephone service, internet access, and other broadband services. It is expected that this assortment of services will benefit not only residential and business consumers but can also assist in fulfilling the telecommunications and information technology needs of schools, libraries, health care providers, and rural communities. Thus, as the Commission indicates in its Notice, "[t]he record of this proceeding strongly supports the conclusion that LMDS is a potentially important source of competition to both LECs and cable operators."[1]

The Commission has proposed to grant only one LMDS license in each geographic license area, known as a Basic Trading Area (BTA), which raises the question whether LECs and cable operators should be eligible to bid for and hold an LMDS license within their current service areas. For the reasons set forth below, NTIA strongly recommends that the Commission

1/ First Report and Order and Fourth Notice of Proposed Rulemaking, CC Docket No. 92-297, FCC 96-311, ¶125 (released July 22, 1996) (Notice).

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establish bidding eligibility and cross-ownership rules that bar incumbents from acquiring LMDS licenses in service areas where they possess market power, as discussed further below.[2/]

Incumbent LECs and cable operators generally possess market power within their existing service areas. This power creates the distinct probability that such firms will have the ability and the incentive to outbid non-incumbents for LMDS licenses. If properly designed, the auction winner will be the bidder that values the LMDS license the most. The value any bidder places on an LMDS license is based upon the profits it expects to earn from obtaining the license. In the case of an incumbent with market power, this value is augmented by the value the incumbent places on the current profits it expects to lose as a result of losing the auction. Because of this additional value, such incumbents can be expected to outbid, all things being equal, non-incumbents for LMDS licenses.

Allowing incumbents with market power to bid for LMDS licenses could limit the competitive benefits to be gained from LMDS service. A LMDS licensee would have the choice of using its spectrum to provide telephony, video, and/or other services. A license holder who also possesses market power with respect to one of these services would have the incentive to limit expansion in its service output in an effort to maintain its supra-competitive price. If consumers' economic interests were maximized by such expansion, these interests would go unfulfilled because the incumbent would have no incentive to create such expansion.

In contrast, consumers' interests and those of a non-incumbent tend to be aligned. Because it lacks market power, a non-incumbent would use its LMDS license to enter the service market (e.g., telephony or video) with the highest expected return. A non-incumbent's decision would not be influenced by concerns over a decline in its existing price due to expansion in service output. Rather, a non-incumbent would simply enter the market in which the fewest competitive pressures exist and, in so doing, make a business decision that is consistent with consumers' interests. Because of these factors, NTIA recommends that the Commission adopt bidding eligibility and cross-ownership rules that prohibit incumbent LECs and cable operators from acquiring an LMDS license in service areas where they possess market power.[3/]

Some commenters offer reasons why incumbent providers should be permitted to acquire LMDS licenses in markets where they possess market power. The most compelling reason -- if true -- states that a LEC or cable operator may be able to obtain economies of scope from

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2/ See infra fn. 4 and accompanying text.

3/ NTIA recognizes that eligible bidders may not come forward to bid on, or otherwise seek to acquire, LMDS licenses in some service areas, such as those within rural areas. In such a case, the Commission should take appropriate action, including granting waivers, to the incumbent LEC or cable operator.

providing both LMDS and its other services or may be able to reduce its costs of providing its current services by substituting LMDS spectrum for other more costly inputs. Without convincing evidence of the existence and substantial size of such efficiencies -- and the record in this proceeding provides none -- that claim is wholly speculative. In the absence of reliable information and given incumbents' incentives and their likely ability to thwart the growth of LMDS, the Commission should retain a healthy skepticism toward incumbents' claims of substantial potential efficiency gains.

The extent to which a particular incumbent may threaten the efficient use of an LMDS license will vary, however, because the geographic area served by an incumbent is likely to constitute only a portion of the LMDS service area. While incumbents may have a strong incentive to act anticompetitively in using LMDS spectrum in their own service areas, their ownership of a license could promote consumers' interests where they are the highest-valued users of LMDS spectrum. This could be the case especially in those areas within BTAs that do not overlap with the incumbents' service areas. Given this possibility, the Commission should not adopt a blanket prohibition against incumbent ownership. Rather, the Commission should specify a very small limit as the amount of overlap a bidder can have between its existing service area and the LMDS service area.[4/] Importantly, because of the incentive a group of eligible

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4/ NTIA recommends that the Commission adopt a cross-ownership rule that would prohibit incumbent LECs and cable operators from owning an LMDS license if at least 10 percent of the population within that license's service area is also within the incumbents' service area. The Commission's cellular/Personal Communications Service (PCS) cross-ownership rule provides useful guidance on this issue. See Notice at ¶132 (proposing rule consistent with cellular/PCS cross-ownership restriction). That rule would have prohibited a cellular licensee from holding a broadband PCS license of more than 10 MHz if 10 percent or more of the PCS service area's population overlapped with the cellular licensee's geographic service area. Although the Commission's cellular/PCS cross-ownership rule was deleted by the Commission after being remanded by the U.S. Court of Appeals for the Sixth Circuit, NTIA believes that the record in the instant proceeding supports the imposition of such a restriction. See Cincinnati Bell Telephone Co.v. F.C.C., 69 F.3d 752 (6th Cir. 1995)(10% overlap rule not based on record evidence that cellular licensees possessed potential to exert undue market power with additional PCS licenses.) Incumbent LECs and cable operators are generally monopoly providers within their service areas, unlike cellular providers, which have been licensed as duopoly services. Further, because the Commission has proposed to award only one LMDS license in each BTA the incumbents would be better positioned to exert undue market power in their respective marketplaces than cellular providers are with respect to PCS.

incumbents has to acquire such licenses collectively, the limit should also apply to a collection of incumbent providers.

In closing, NTIA hopes that the Commission will take advantage of this rare opportunity to promote viable competition in local telephony and video service markets. By prohibiting incumbent LECs and cable operators that possess market power within their service areas from bidding on and holding the sole LMDS license in those same areas, the Commission can help consumers realize the benefits of a robustly competitive marketplace.

If you have any questions, please call me at (202) 482-1840.

Sincerely,

Larry Irving

cc: Commissioner Rachelle Chong
Commissioner Susan Ness
Commissioner James Quello
William E. Kennard, General Counsel